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In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 104

ALEXANDER TCHEREPNIN, ET AL., PETITIONERS

v.

JOSEPH E. KNIGHT, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

OPINIONS BELOW

The opinion of the district court (R. 29) has not been reported. The opinions of the court of appeals (R. 43) are reported at 371 F. 2d 374.

JURISDICTION

The judgment of the court of appeals was entered on January 20, 1967 (R. 65). The petition for a writ of certiorari was filed on April 20, 1967, and was

granted on June 5, 1967 (R. 66). This Court's jurisdiction rests upon 28 U.S.C. 1254(1).

STATUTE INVOLVED

Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10) provides:

> 3. (a) When used in this title, unless the context otherwise requires—
>
> * * * * *
>
> (10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust, certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

QUESTION PRESENTED

Whether a withdrawable capital share in a savings and loan association is a "security" under the Securities Exchange Act of 1934.

THE INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The federal securities laws comprise a regulatory scheme designed to foster the integrity of the nation's capital market and to afford a means of protection for members of the investing public. The Securities and Exchange Commission is charged with the administration and enforcement of those laws. The Securities Exchange Act of 1934 alone among the federal securities laws gives the Commission authority to promulgate rules and regulations that define unlawful "manipulative and deceptive" practices in connection with securities transactions (Section 10(b), 15 U.S.C. 78j(b)), and to regulate brokers and dealers who solicit or otherwise deal with the investing public (Section 15, 15 U.S.C. 78o).

The decision of the court of appeals that a withdrawable interest in a savings and loan association is not a "security" as defined in that Act, not only renders unavailable to a large number of investors[1] private remedies under the Act[2] but would seem to

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[1] In May 1967, more than $113 billion of savings capital were invested in more than 41 million accounts in the 4,497 savings and loan associations insured by the Federal Savings and Loan Insurance Corporation, representing about 96% of the resources of all operating savings and loan associations. Federal Home Loan Bank Board, FSLIC *Insured Savings and Loan Associations, Savings and Mortgage Lending Activity—Selected Balance Sheet Data, May 1967*, Table 3 (June 1967).

[2] The decision of the court of appeals does not affect the applicability to savings and loans shares of the antifraud provisions contained in Sections 12(2) and 17 of the Securities Act of 1933 (15 U.S.C. 77*l*(2) and 77q). But those provisions

preclude the Commission from acting for their protection.[3]

The decision would also exempt brokers and dealers in such shares from the registration requirements of Section 15 (15 U.S.C. 78o), and the various obligations the Act imposes upon brokers and dealers. A number of registered broker-dealers are engaged in the solicitation of funds for deposit in savings and loan accounts. Finally, the restrictive meaning the court of appeals has given to the statutory defini-

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would not be fully effective in preventing misleading and manipulative practices. The 1934 Act covers not only fraud by sellers but also fraud by purchasers of securities. Fraud in the purchase of savings and loan share accounts could occur whenever there may be uncertainty as to the time or amount of payment, as when an association is in liquidation, and the owners of such accounts are induced to sell them by misrepresentations as to the amount they are likely to realize, how long the liquidation will take, etc. Moreover, Section 10(b) of the 1934 Act and Rule 10b-5 apply to fraud "in connection with" securities transactions, and thus have a broader reach than the antifraud provisions of the 1933 Act, which only cover fraud "in" such transactions.

[3] The prevention of deceptive and manipulative practices through litigation under Section 10 of the 1934 Act has constituted an important aspect of the Commission's work. See, *e.g.*, *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 258 F. Supp. 262 (S.D.N.Y.) (appeal pending); *Securities and Exchange Commission* v. *Georgia Pacific Corp.*, No. 66 Civ. 1215 S.D.N.Y. (May 23, 1966); Securities and Exchange Commission, *32d Annual Report* (1966), pp. 114-116. Section 10b has also become an increasingly effective tool in the hands of private litigants. See, *e.g.*, *Vine* v. *Beneficial Finance Co.*, CCH Fed. Sec. Rep. ¶ 91,906 (C.A. 2); *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C.A. 5).

tion of the term "security," if allowed to stand, would seriously hamper the Commission's efforts to deal with novel types of financial instruments as they appear.

STATEMENT

This is an action brought by a group of holders of withdrawable capital shares of respondent City Savings Association. City Savings is a corporation doing business under the Illinois Savings and Loan Act (32 Ill. Rev. Stat. 701-944). Its capital is represented exclusively by withdrawable capital accounts, evidenced "by one or more appropriate certificates * * *."[4] Each holder of one or more withdrawable shares is a member of the association (Section 741(a)(1)), entitled to "the vote of one share for each one hundred dollars of the aggregate withdrawal value of such accounts" or fraction thereof at meetings of the members (Section 742(d)(2)).[5] The profits, if any, of such associations are apportioned, at least annually, by the declaration of dividends "on withdrawable shares

[4] 32 Ill. Rev. Stat. 768(a). Such certificate "or an account book, or both" must be delivered to the shareholders. *Ibid.* Although the Illinois statute permits an association's capital to be "represented by withdrawable capital accounts (shares and share accounts) or permanent reserve shares or both * * *" (32 Ill. Rev. Stat. 761(a)), it does not appear that the respondent association has ever issued anything except withdrawable capital shares.

[5] Every borrower from the association, so long as his loan remains unpaid, is also deemed a member (32 Ill. Rev. Stat. 741(a)(2)), although a borrowing member is entitled only to the vote of one share as such (Section 742(d)(4)).

and share accounts" (Section 778(a)). City Savings is being liquidated.

The complaint alleges that the "capital shares issued by and capital account interests in City Savings" that were purchased by petitioners (R. 4) are securities within the meaning of Section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(10)), that petitioners purchased such securities in reliance upon printed solicitations received from City Savings through the mails (R. 5), and that such solicitations contained false and misleading statements violative of Section 10(b) of the Securities Exchange Act (15 U.S.C. 78j(b)) and of the Commission's Rule 10b-5 thereunder (17 CFR 240.10b-5) (R. 5). In particular, the complaint alleges that the solicitations represented City Savings to be a financially strong association and its shares to be a desirable investment but failed to disclose, *inter alia*, that the association was controlled by a person previously convicted of mail fraud involving savings and loan associations (R. 7), that the association had been denied federal insurance of its shareholder accounts because of its unsafe financial policies (R. 10), and that the association had been forced to restrict withdrawals by holders of previously purchased shares (R. 10-11). Petitioners allege that sales of shares in these circumstances were void under Section 29(b) of the Securities Exchange Act (15 U.S.C. 78cc(b)), and they seek rescission (R. 6):

The Court of Appeals for the Seventh Circuit (Judge Cummings dissenting) held that the complaint should have been dismissed by the district court

because the withdrawable capital shares were "not encompassed in the definition of a 'security' under the 1934 [Securities Exchange] Act" (R. 52).

SUMMARY OF ARGUMENT

Section 3(a)(10) of the Securities Exchange Act of 1934 broadly defines "security" to include, among other things, any "investment contract," "certificate of interest or participation in any profit-sharing agreement," "transferable share" and "stock." The substantially identical definition of "security" in the Securities Act of 1933 includes the same terms, and there is no reason to believe that Congress intended them to have any narrower meaning in the 1934 Act than in the earlier one. Under this Court's decisions in *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, and *Securities and Exchange Commission* v. *W. J. Howey Co.*, 328 U.S. 293 —both cases under the 1933 Act—an "investment contract" was defined as involving "an investment of money in a common enterprise with profits to come solely from the efforts of others" (*Howey*, 328 U.S. at 301). This would clearly include a share account in a savings and loan association. Share accounts also come within the three other terms listed above, since they represent the capital of the enterprise, are transferable by assignment, and entitle the holder to participate in profits realized in the operations of the business.

The court of appeals erroneously assumed that the meaning of these terms was limited by the catch-all

phrase at the end of the definition, "any instrument commonly known as a 'security'." In the *Joiner* case this Court rejected a similar attempt to qualify the broad terms of the definition in the 1933 Act, and the same reasoning is equally applicable here. The court of appeals also erred in assuming that only those interests that are speculative, fluctuate in value and are traded on organized markets constitute a security. See *Howey*, *supra*.

The legislative history of the Securities Act of 1933 shows that Congress in passing that Act recognized that share accounts in savings and loan associations were covered by the definition of "security." Congress, however, exempted such shares from the registration requirements of the 1933 Act because of the burdens of such registration, but made them subject to the Act's antifraud provisions. Representatives of the savings and loan industry recognized during the hearings on the 1933 Act that they would be subject to the latter provisions.

Since savings and loan shares were clearly understood to be within the definition of "security" adopted by Congress for the 1933 Act, it would take compelling evidence to demonstrate that such shares are not covered by the substantially identical definition adopted by the same Congress for the 1934 Act. No such evidence has been presented. Indeed, the complete silence of the legislative history of the 1934 Act with respect to savings and loan shares is inconsistent with the supposition that Congress abruptly departed from its earlier understanding that such shares are securities.

The fact, which the court of appeals deemed significant, that the phrase "evidence of indebtedness" is included in the definition of security in the 1933 Act but not included in the 1934 Act, is irrelevant. Since, as we have shown, share accounts are covered by several terms common to both Acts, the omission of the term "evidence of indebtedness" is immaterial. The omission is further irrelevant here because petitioners are not creditors and their share accounts represent an equity rather than a debt interest.

Finally, the conclusion that share accounts are securities under the 1934 Act is supported by the Commission's settled administrative interpretation of that Act. The Commission repeatedly has taken actions resting upon a determination that such accounts are covered by the Act, and Congress in 1964 confirmed and approved the Commission's view.

ARGUMENT

A Share Account in a Savings and Loan Association Is a "Security" Under the Securities Exchange Act of 1934.

A. *The Definition of "Security" in Section 3(a)(10) of the Act Covers Share Accounts.*

Section 3(a)(10) of the Securities Exchange Act of 1934 broadly defines "security" to include, *inter alia*,

> any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment con-

> tract, voting-trust certificate, certificate of deposit for a security, or in general, any instrument commonly known as a 'security'. * * *.

This definition is substantially the same as the definition of "security" in the Securities Act of 1933.[6] There is nothing to indicate that when Congress used the same words in both Acts it intended them to be construed more narrowly in the later than in the earlier one; and if the same Congress which passed the Securities Act of 1933 intended to narrow the reach of the additional protections that it gave to investors one year later, it presumably would have given some indication of such an intent. Thus, if a share account in a savings and loan association is a security under the 1933 Act,[7] it is also a "security" under the 1934 Act, if it is within any of the terms common to both acts.

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[6] Section 2 of the Securities Act of 1933, 15 U.S.C. 77b, provides:

> When used in this title, unless the context otherwise requires—
>
> (1) the term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security"; * * *.

[7] We shall refer to the Securities Act of 1933 as the "1933 Act" and to the Securities Exchange Act of 1934 as the "1934 Act."

The decisions of this Court in *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, and *Securities and Exchange Commission* v. *W. J. Howey Co.*, 328 U.S. 293—both cases under the 1933 Act—leave no doubt that petitioners' share accounts in City Savings constitute "investment contracts" within the meaning of both definitions. In *Howey* the Court pointed out that although "[t]he term 'investment contract' is undefined by the Securities Act or by relevant legislative reports * * *, it had been broadly construed by state courts so as to afford the investing public a full measure of protection. Form was disregarded for substance and emphasis was placed upon economic reality" (328 U.S. at 298). Stressing the "economic reality" of the interest there involved, the Court ruled that when a "person invests his money in a common enterprise and is led to expect profits solely from the efforts of * * * a third party," his interest, "regardless of the legal terminology in which * * * [it might be] clothed," is an "investment contract" (328 U.S. at 299-300).

Petitioners, too, have invested their capital in a common enterprise—a money lending business with prospects for success dependant upon the skill of the managers in making suitable loans upon adequate security. If the managers are unskilled, improvident or dishonest, the purchasers of the share accounts are likely not only to forego any return on their investment but also to lose a substantial part thereof—as petitioners all too well know.[8]

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[8] The court below apparently rejected application of the *Howey* test in part because "[t]he profit is derived from

Petitioners' interests "on their face * * * answer to the name or description" of certain of the other categories set forth in the definition of "security". *Joiner*, *supra*, 320 U.S. at 351. The attributes of a withdrawable capital share under the Illinois Savings and Loan Act, pursuant to which it is issued, make it a "certificate of interest or participation in any profit-sharing agreement," a "transferable share," and "stock." The profit-sharing nature of the agreement (required to be evidenced by a certificate, 32 Ill. Rev. Stat. 768(a)) to which the petitioners became parties by their purchase is shown by the statutory provision that "[d]ividends * * * may be declared * * * on withdrawable shares and share accounts" after provi-

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loans to other members of the savings and loan association. This is not investment in a common enterprise with profits to come solely from the efforts of others" (R. 48-49). But the modern savings and loan association does not, as the court's language suggests, restrict its investments to loans to account holders. In Illinois, for example, an association may invest not only in obligations of members, 32 Ill. Rev. Stat. 791, but may also make other loans or other investments, *id.* 792-792-10. The fact that all borrowers and all obligors of other investments become "members" by virtue of such loan or investment, whether or not they are capital account holders, see *id.* 741, is irrelevant to application of the principles set forth in *Howey*. Furthermore, there is no suggestion in the Illinois Act that shareholders, as such, are entitled to participate in management decisions. Profits of the association, if any, depend entirely upon the manner in which the board of directors exercises its authority to conduct the business and affairs of the association, see 32 Ill. Rev. Stat. 744, and if shareholders usually give irrevocable proxies, as the court below suggests (R. 47), such shareholders surrender even residual control of their investment to the corporate management.

sion has been made for reserves. 32 Ill. Rev. Stat. 778. The interests involved are transferable shares since the statute provides that "the holder of a withdrawable capital account may transfer his rights therein absolutely or conditionally to any person eligible to hold the same * * *." *Id.* 768(b).[9]

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[9] The term "share" is used in conjunction with every significant right which petitioners obtained by virtue of their purchases. See, *e.g.*, 32 Ill. Rev. Stat. 741 (membership); *id.* 742(d)(2) (voting); *id.* 778(c) (participation in profits as dividends). See also Reply to Briefs in Opposition, p. 3, for an exhaustive analysis of that and similar terms employed in the Illinois Act. In this respect, the provisions of the Illinois statute appear to be typical. See Bodfish, *Savings and Loan Principles* (1938) pp. 130-131:

> Savings and loan shares are founded upon many of the same fundamental principles as shares in other corporations. They represent portions of ownership in the assets of the association. * * * It gives its owner the right to participate in the designation of the management of the business, to undertake the risk of loss, and to share in the profits. Savings and loan association shares differ from stock in most other corporations, however, in one important aspect. The association has the right under the laws to repurchase its own shares and, when its funds are available, must do so if account holders wish to withdraw.

The members of the congressional committees which held the hearings on both the 1933 Act and the 1934 Act repeatedly referred during the hearings on the former to interests in savings and loan associations as "shares" and "stock." See Hearings on H.R. 4314 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess. 70-80 *passim* (1933); Hearings on S. 875 before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess. 50-54, 99-101, 110-113 *passim* (1933).

See, also, *Fahey* v. *Mallonee*, 332 U.S. 245, 255, 257; *Veix*

Finally, contrary to the apparent view of the court of appeals, the catch-all phrase at the end of the definition, "any instrument commonly known as a 'security,'" does not limit the reach of the preceding words in the definition.[10] Rather, it expands the definition to

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v. *Sixth Ward Bldg & Loan Assn.*, 310 U.S. 32, 34, 35, 36, 38, 40; *Treigle* v. *Acme Homestead Assn.*, 297 U.S. 189, 191, 192, 193, 197; *Hopkins Fed. Sav. & Loan Assn* v. *Cleary*, 296 U.S. 315, 327, 329, 331, 332, 333, 336, 339, 340, 341; *Bedford* v. *Eastern Bldg. and Loan Assn*, 181 U.S. 227, 237, 238, 239, 240-242.

[10] The court of appeals' analysis of the ways in which share accounts differ from "the ordinary concept of a security" (R. 47) will not bear scrutiny. The attributes emphasized by the court do not determine the existence of a security, but merely distinguish among securities of different types, since interests which are indisputably securities possess these characteristics. Thus, like interests in savings and loan associations, shares of mutual funds may be issued in unlimited amounts and without preemptive rights (see *Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth*, H. Rep. No. 2237, 89th Cong., 2d Sess. 54-55, 201 (1966)), and they may be redeemed at the option of the shareholders at any time (see Sections 2(a)(31) and 5(a) of the Investment Company Act of 1940, 15 U.S.C. 80a-2(a)(31) and 80a-5(a)). See also *Securities and Exchange Commission* v. *United Benefit Life Insurance Company*, 387 U.S. 202, 205. A right of retirement by the issuer is a frequent incident of preferred stock (see 11 Fletcher, *Cyclopedia Corporations* § 5309, pp. 912-914 (1958 rev.)). That savings and loan interests may be transferable only by assignment and are not made subject to the Uniform Commercial Code merely reflects the fact that this type of security is not a usual medium for trading in the markets. This is equally true of the type of investment contracts in the *Joiner* and *Howey* cases. Similarly, holders of the types of interests involved in those cases would presumably

cover other forms of joint investment participation in a common enterprise for profit. "[T]he reach of the Act does not stop with the obvious and commonplace." *Securities and Exchange Commission* v. *C. M. Joiner Corp.*, 320 U.S. at 351. In the *Joiner* case this Court refused to "read out of the statute * * * general descriptive designations merely because more specific ones have been used to reach some kinds of documents" (p. 351), and refused to "constrict the more general terms substantially to the specific terms which they follow" (p. 350). And in *Llanos* v. *United States*, 206 F. 2d 852, 854 (C.A. 9), certiorari denied, 346 U.S. 923, the court rejected the contention that a similar phrase in the 1933 Act "limits those which come before."

Noting that the 1933 and the 1934 Acts "were passed in the aftermath of the great economic disaster of 1929," the court below suggested that in determining whether an interest is a security, weight should be given to whether it is speculative, of a fluctuating value and traded on an organized market (R. 47, 49, 51), and it stressed the absence of these qualities in

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not be "entitled to inspect the general books and records" of the issuer (R. 47). Indeed, this is a right available only under unusual circumstances to corporate bondholders. As Judge Cummings showed in his dissenting opinion (R. 60-61), there is no warrant for the assumption that the Illinois legislature did not regard share accounts as securities. But even if the court of appeals were correct in supposing that "the Illinois legislature did not intend [share accounts] to be securities" (R. 47), its conclusion that they are, therefore, not "commonly known as a security" is a *non sequitur*.

share accounts. This Court rejected a similar test in *Howey*, however, where it said:

> We reject the suggestion of the Court of Appeals, 151 F. 2d at 717, that an investment contract is necessarily missing where the enterprise is not speculative or promotional in character * * *. The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative * * *. [328 U.S. at 301.]

In other words, whether particular interests are "securities" under the 1933 or the 1934 Act does not depend upon whether they are speculative or regularly traded, but whether they constitute the kind of interest to which Congress intended the protections of the federal securities laws to apply. In any event, the fact is that share accounts have been actively traded on at least one organized securities market, and the regulatory provisions of the 1934 Act were then assumed to be applicable. See *infra*, p. 23.

B. *Congress Plainly Intended the Term "Security" in the Securities Act of 1933 to Include Share Accounts, and it did not Intend that Term to Have Any Narrower Meaning Under the 1934 Act.*

1. Congress plainly intended to treat share accounts as securities when it passed the 1933 Act. The testimony before the congressional committees shows that savings and loan associations were known to be subject to the abuses that the Act was aimed at. Mr.

Huston Thompson, a former member of the Federal Trade Commission who had been active in drafting the bill, testified before the Senate committee that the building and loan association was "a favorite title for the blue-skyer to use, and he has certainly used it over this country, and it has caused great loss." *Senate Hearings, supra,* p. 99. Another witness testified before the House committee that "in the East the good name of the building and loan associations has been used by some promoters for most fraudulent purposes." *House Hearings, supra,* p. 75. A senator observed that he did "not know of any set of organizations that need regulation and supervision in the matter of the selling of their stock any more than building and loan associations." *Senate Hearings, supra,* p. 111.

Moreover, the representatives of the savings and loan industry apparently recognized that they would be subject to the Act, and sought an exemption from its registration provisions on the ground that the small associations, which made continuous offerings of their shares, would find it extremely burdensome to comply with those requirements. Those industry representatives were explicit that they sought only a limited exemption and repeatedly professed to welcome the coverage of their companies by the Act's antifraud provision.[11] For example, Morton Bodfish, executive

[11] See Hearings on H.R. 4314 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess. 70-80 (1933) (testimony of Mr. Morton Bodfish, Executive Manager, United States Building and Loan League); Hearings on S. 875 before the Senate Committee on Banking and Cur-

manager of the United States Building and Loan League, testified before the House committee: [12]

> When a person saves his money in a building and loan association, he purchases shares and nearly all of our $8,000,000,000 of assets are in the form of shares * * *.
>
> The practical difficulties of an association having to register every issue of shares with the Federal Trade Commission are obvious. * * *
>
> * * * *
>
> I would emphatically point out to the committee that we are in accord with [the antifraud provisions] which would apply to all of our associations if there are any improper or fraudulent or deceptive practices. The exceptions to the submission of reports and the like * * * do not apply to [the antifraud provisions] * * *.
>
> * * * *
>
> Now, gentlemen, we want you to leave the fraud sections there, just as they are, so that any fraud developed in connection with the management of any of our institutions anywhere or under the name of building and loan, this law can be effective and operative.
>
> We do think, as a practical matter, you should leave these 11,442 building and loan associations, which are mainly small community institutions, out from the routine reporting and registering of their securities every time they start to issue more stock * * *.

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rency, 73d Cong., 1st Sess. 50-54 (1933) (testimony of Mr. C. Clinton James, Chairman, Federal Legislative Committee of the United States Building and Loan League).

[12] House Hearings, *supra*, pp. 71-74.

In accordance with this and similar requests, savings and loan securities were added to the list of "exempted securities" in Section 3(a) of the Act. If share accounts were not covered by the definition of "security" in the 1933 Act, there was neither need nor occasion to give them such an exemption.

This background demonstrates that savings and loan shares were understood to be included in the general definition of "security," but were exempted from the provisions of the 1933 Act other than the antifraud provisions. Certainly the savings and loan industry has never doubted it.[13] Nor has the Securities and Exchange Commission or the courts.[14]

2. Since savings and loan shares are clearly within the definition of "security" adopted by Congress for

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[13] See Richards, *The Federal Securities Act*, 1933 Building and Loan Annals 111; American Savings, Building & Loan Institute, *The Federal Securities Act—a Building and Loan Problem*, Savings and Loans, November, 1933, p. 3. See also p. 26, *infra*.

[14] See *W. K. Archer & Co.*, 11 S.E.C. 635, 643-644, affirmed, 133 F. 2d 795 (C.A. 8), certiorari denied, 319 U.S. 767. The Commission has obtained consent decrees in injunction actions for violations of Section 17(a) of the Securities Act in the sale of savings deposit pass books of savings and loan associations. *Securities and Exchange Commission* v. *First Capital Savings and Loan Association* (D. Md., 60 Civ. 12115, May 8, 1960); *Securities and Exchange Commission* v. *American Seal Savings and Loan Association* (D. Md., 60 Civ. 12172, June 19, 1963). The Commission has also obtained an injunction for violation of the registration provisions of that Act in the sale, *inter alia*, of "preferred stock," evidenced by deposit books, by an organization called a savings and loan association but found not to be qualified for the exemption. *Securities and Exchange Commission* v. *American International Savings & Loan Ass'n*, 199 F. Supp. 341 (D. Md.).

the 1933 Act, it would take compelling evidence to demonstrate that such shares were not understood to come within the virtually identical definition adopted by the same Congress for the 1934 Act. No such evidence has been presented. Indeed, so far as we have been able to ascertain, the legislative history of the 1934 Act is silent with respect to savings and loan shares. The Senate Report does state, however, that the definition of "security" in the 1934 Act was intended to be "substantially the same as [that contained] in the Securities Act of 1933." S. Rep. No. 792, 73d Cong., 2d Sess. 14 (1934).

Lacking any support in the legislative history, both the court of appeals (R. 48) and respondents (Brief in Opposition for City Savings Assoc. *et al.*, pp. 6-7, 12, 15) suggest policy reasons why the 1934 Act, and its antifraud provisions in particular, should not apply to savings and loan shares. But whatever the merit of those considerations, they prove too much; for they are equally applicable to the 1933 Act which, as shown, plainly does cover such shares. If, as we think evident, Congress understood savings and loan shares to be securities in 1933, there is no reason to believe that Congress did not regard them as securities in 1934. Indeed, there are persuasive policy reasons why Congress would not have wanted to exclude share accounts from the coverage of the 1934 Act. Those who commit their capital to a savings and loan association require the protections of the antifraud provisions of and the benefits of the Commission's broker-dealer regulation under that Act just as much as those who participate in other investment ventures.

3. The court of appeals placed great reliance on the fact that the term "evidence of indebtedness," which was included in the otherwise similar definition of "security" in the 1933 Act was omitted from the definition in the 1934 Act. There are several answers to this point. *First*, since, as shown above, share accounts are within terms defined to be securities by both the 1933 and 1934 Acts, without regard to the phrase "evidence of indebtedness," [15] its omission from the 1934 Act is irrelevant. *Second*, the point is further irrelevant in the present case since, contrary to the court's supposition, petitioners are not creditors and their share accounts are an equity rather than a debt interest.[16] *Third*, since the legislative history of

[15] As noted above (pp. 11-13), shares accounts come within such specified categories as "transferable share" and "investment contract." It has been held that an investment contract may be predicated on underlying debt securities. In *Los Angeles Trust Deed and Mortgage Exchange* v. *Securities and Exchange Commission*, 285 F. 2d 162 (C.A. 9), certiorari denied 366 U.S. 919, persons selling and servicing trust deed and mortgage notes of others were held to be issuing investment contracts, and were enjoined not only from violating the Securities Act but also from acting as unregistered dealers in securities under the Securities Exchange Act.

[16] See Judge Cummings' dissenting opinion (R. 59-61) which points out that under Illinois law a holder of a withdrawable share account does not become a creditor even upon filing an application for withdrawal (32 Ill. Rev. Stat. 773 (f)). Moreover, the authority of an Illinois saving and loan association to borrow money is governed by a provision (32 Ill. Rev. Stat. 707) entirely different from that governing the issuance of share accounts (32 Ill. Rev. Stat. 761(a)). See, also, n. 9, *supra*, p. 13.

The legislative history cited by the court of appeals (Hearings on S. 875 before the Senate Committee on Banking and

the 1934 Act offers no indication as to the considerations, if any, that prompted the omission of the phrase "evidence of indebtedness," the assumption that a highly significant change was intended seems unwarranted and inherently implausible.[17]

C. *The Commission Consistently has held Share Accounts to be Securities Under the 1934 Act.*

The conclusion that share accounts are securities under the 1934 Act is further supported by the Com-

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Currency, 73d Cong., 1st Sess. 94-120 *passim*) does not justify the court's statement that "[s]ome of the Senators evidently saw a relationship between this term 'evidence of indebtedness' and accounts in building and loan associations * * *" (R. 50).

[17] As an ancillary argument, the court of appeals suggested that share accounts are "mature at issue" and, therefore, fall within the 1934 Act's exclusion of notes maturing within nine months (R. 47). This argument is untenable. First, of all, the exclusion of short-term commercial paper under the 1934 Act, and its exemption under the 1933 Act, were responsive to the particular needs of a distinct type of commerce having nothing in common with share accounts. See, *e.g.*, Hearings on S. 875 before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess. pp. 94-95. Secondly, had the 1933 Act's exemption for short-term paper (Section 3(a)(3)) been thought to cover savings and loan association securities, there would have been no reason to provide a separate exemption for "[a]ny security issued by a * * * savings and loan association * * *" (Section 3(a)(5)). Finally, the fact that withdrawable capital share accounts may be said to be "mature at issue" in the sense that the investment may be immediately withdrawn does not distinguish them from variable annuities (see *Securities and Exchange Commission* v. *United Benefit Life Ins.*, 387 U.S. 202, 205) or mutual fund shares (see Sections 2(a)(31) and 5(a) of the Investment Company Act of 1940, 15 U.S.C. 80a-2(a)(31) and 80a-5(a)), both of which are securities.

mission's settled administrative interpretation of that Act.

In 1934, within a few months after the passage of the Act, the Commission, on application of the Cleveland Stock Exchange, temporarily exempted from the provisions of Sections 7, 8, 12 and 13 of that Act, "[p]ass books of * * * savings and loan companies" which at that time were being "traded in on the Cleveland Stock Exchange * * *." See Securities and Exchange Commission Release No. 26, October 22, 1934. In 1942, pursuant to Section 15(b) of the Act, the Commission revoked the registration of a broker and dealer in securities based, *inter alia*, upon a fraudulent sale of savings and loan association certificates, on the ground that the transaction violated both Section 17(a) of the 1933 Act and Section 15(c)(1) of the 1934 Act. *W. K. Archer & Co.*, 11 S.E.C. 635, 643-644, *affirmed*, 133 F. 2d 795 (C.A. 8), certiorari denied, 319 U.S. 767.[18] Both of these actions necessarily were grounded on the premise that share accounts are securities under the 1934 Act.

The Commission has also required securities brokers and dealers whose business is exclusively the solicitation of funds for deposit in savings and loan accounts to register with the Commission pursuant to Section

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[18] The record before the court of appeals in that case demonstrates that the certificates evidenced withdrawable stock; see Petitioner's Abstract of Record, pp. 179-181, *Archer* v. *Securities and Exchange Commission*, Sup. Ct. No. 1005, O.T., 1942, and the court of appeals, in affirming, did not question the Commission's treatment of those certificates as securities. See 133 F. 2d at 801.

15 of the 1934 Act,[19] which prohibits unregistered brokers and dealers from effecting transactions in "any security" in the over-the-counter market. Form SECO-3, which the Commission adopted on September 7, 1965, requested information about the "Principal type of Securities Business engaged in" by certain brokers and dealers and listed, as one type of such business, "Solicitor of savings and loan accounts." See SEC Securities Exchange Act Release No. 7697 (September 7, 1965). In response, 14 registered broker-dealers indicated that this was their principal type of securities business.[20]

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[19] For example, B. C. Morton & Co., Inc., SEC Files No. 8-3532-1, in a certificate filed on December 29, 1961, stated that its "only business is the solicitation of funds from the public for deposit with Federal Savings and Loan Associations * * *." Federal associations are mutual institutions which issue no permanent form of capital and are not permitted to accept deposits which evidence debt. See 12 U.S.C. 1464(a) and (b); 12 CFR 554.1(a) (Chapter N, Para. 3(6)); 12 CFR 554.1 (b) (Chapter K, Para. 3(6)). Some registered brokers solicit subscriptions for investment certificates as well as for withdrawable shares, see, *e.g.*, Edward L. Johnson, SEC File No. 8-10416-1, Registrants Verification, sworn to February 11, 1966 ("the securities business of Edward L. Johnson has been limited to acting as broker for eleven savings and loan associations * * * in soliciting subscriptions for investment certificates and withdrawable shares of such associations * * *"). Others may solicit funds on behalf of banks as well as savings and loan associations. See Leonard Goldberg, SEC File No. 8-4100-1, Certificate of Independent Public Accountant, filed November 30, 1966 (" * * * his business is limited to acting as agent for soliciting depositors in Savings Banks or Savings and Loan Associations").

[20] See SEC Files Nos.: 8-4819-1, 8-4100-1, 8-11396-1, 8-10818-1, 8-11542-1, 8-11480-1, 8-10416-1, 8-11797-1, 8-3532-1, 8-10240-1, 8-10942-1, 8-10098-1, 8-10104-1, 8-7958-1.

Congress confirmed and approved the Commission's view in 1964, when it amended the 1934 Act to cover certain issuers of equity securities. For in response to a statement by the Commission that an explicit exemption was needed if withdrawable shares of savings and loan associations were not to be covered by the new provisions,[21] Congress specifically excluded "any security, other than permanent stock, guaranty stock, permanent reserve stock, or any similar certificate evidencing non-withdrawable capital, issued by a savings and loan association * * *." Section 12(g)(2)(C) of the 1934 Act, 15 U.S.C. 78*l*(g)(2)(C). It thus recognized that withdrawable shares of savings and loan institutions came within the definitions of "security" and "equity security"[1] [22] in that Act.[23]

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[21] See *Technical Statement of the Securities and Exchange Commission*, Hearings on H.R. 6789, H.R. 6793 and S. 1642 before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 88th Cong., 1st Sess. 211, 215 (1963); *Memorandum of the Securities and Exchange Commission, id.* at 1360, 1361.

[22] Section 3(a)(11), 15 U.S.C. 78c(a)(11), defines "equity security" to mean "any stock or similar security * * *."

[23] Other federal agencies that regulate financial institutions have called attention to the Commission's position. Identical letters dated December 16, 1966 from the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the Board of Governors of the Federal Reserve System, to the banks and savings and loan associations within their respective regulatory jurisdictions, called attention to the Commission's opinion that "deposit and share accounts are subject to the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 and that advertisements by financial institutions that are

Finally, a representative of the savings and loan industry recently pointed out that the industry itself has long viewed its activities as subject to the antifraud provisions of both the 1933 and the 1934 Acts. The United States Savings and Loan League,[24] in commenting upon the granting of the petition for certiorari in this case, noted that the Commission "contends that deposits and accounts in savings and loan associations are subject to the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934." It stated, however, that "[t]his case is not necessarily as significant and earth shaking in its implications as many savings and loan people assume. In the first place *the savings and loan business always has assumed that it was subject to the antifraud provisions of the Securities Acts* relating to advertising practices, etc. Regardless of how this case goes it does not mean that savings and loan associations will be any more involved with the SEC than they have been in the past. * * *" (emphasis added).

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contrary to such principle may violate those anti-fraud provisions." See The New York Times, December 19, 1966, p. 1, col. 1; p. 22, cols 4-5.

[24] United States Savings and Loan League, *SEC Savings and Loan Case to Supreme Court*, Membership Bulletin, June 28, 1967, p. 15.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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